

INTEVAC INC
Form 10-Q
May 03, 2011

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
FORM 10-Q**

(MARK ONE)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**

For the quarterly period ended April 2, 2011

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**

For the transition period from to

Commission file number 0-26946

INTEVAC, INC.

(Exact name of registrant as specified in its charter)

Delaware

**(State or other jurisdiction of
incorporation or organization)**

94-3125814

(IRS Employer Identification No.)

3560 Bassett Street

Santa Clara, California 95054

(Address of principal executive office, including Zip Code)

Registrant's telephone number, including area code: (408) 986-9888

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated
filer

Accelerated
filer

Non-accelerated filer
(Do not check if a smaller reporting
company)

Smaller reporting
company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No

On May 3, 2011, 22,838,418 shares of the Registrant's Common Stock, \$0.001 par value, were outstanding.

**INTEVAC, INC.
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CONDENSED CONSOLIDATED BALANCE SHEETS**

	April 2, 2011	December 31, 2010
	(Unaudited)	
	(In thousands, except par value)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 25,879	\$ 109,520
Short-term investments	50,263	4,994
Trade, note and other accounts receivable, net of allowances of \$55 at both April 2, 2011 and December 31, 2010	17,560	25,911
Inventories	21,764	20,671
Prepaid expenses and other current assets	6,890	6,630
Deferred income tax assets	3,304	3,124
Total current assets	125,660	170,850
Property, plant and equipment, net	15,252	13,918
Long-term investments	52,294	22,866
Goodwill	18,389	18,389
Other intangible assets, net of amortization of \$1,937 at April 2, 2011 and \$1,801 at December 31, 2010	6,848	6,984
Deferred income taxes and other long-term assets	20,333	18,764
Total assets	\$ 238,776	\$ 251,771
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 5,147	\$ 5,562
Accrued payroll and related liabilities	4,578	11,365
Other accrued liabilities	10,612	11,104
Customer advances	4,805	4,867
Total current liabilities	25,142	32,898
Other long-term liabilities	10,973	11,630
Stockholders' equity:		
Common stock, \$0.001 par value	23	23
Additional paid-in capital	142,281	139,824
Accumulated other comprehensive income	247	255
Retained earnings	60,110	67,141
Total stockholders' equity	202,661	207,243

Total liabilities and stockholders' equity	\$ 238,776	\$ 251,771
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Note: Amounts as of December 31, 2010 are derived from the December 31, 2010 audited consolidated financial statements.

See accompanying notes.

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INTEVAC, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	Three months ended	
	April 2, 2011	April 3, 2010
	(Unaudited)	
	(In thousands, except per share amounts)	
Net revenues:		
Systems and components	\$ 15,491	\$ 28,911
Technology development	1,932	4,231
Total net revenues	17,423	33,142
Cost of net revenues:		
Systems and components	9,614	15,902
Technology development	1,429	2,762
Total cost of net revenues	11,043	18,664
Gross profit	6,380	14,478
Operating expenses:		
Research and development	9,012	6,544
Selling, general and administrative	6,885	6,567
Total operating expenses	15,897	13,111
Income (loss) from operations	(9,517)	1,367
Interest income and other, net	129	391
Income (loss) before income taxes	(9,388)	1,758
Provision for (benefit from) income taxes	(2,357)	328
Net income (loss)	\$ (7,031)	\$ 1,430
Net income (loss) per share:		
Basic	\$ (0.31)	\$ 0.06
Diluted	\$ (0.31)	\$ 0.06
Weighted average common shares outstanding:		
Basic	22,727	22,196
Diluted	22,727	22,975

See accompanying notes.

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INTEVAC, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three months ended	
	April 2,	April 3,
	2011	2010
	(Unaudited)	
	(In thousands)	
Operating activities		
Net income (loss)	\$ (7,031)	\$ 1,430
Adjustments to reconcile net income (loss) to net cash and cash equivalents provided by (used in) operating activities:		
Depreciation and amortization	1,388	1,489
Net amortization of investment premiums and discounts	222	
Equity-based compensation	962	617
Change in the fair value of acquisition-related contingent consideration	300	
Deferred income taxes	(2,385)	34
Loss on disposal of equipment	31	
Changes in operating assets and liabilities	(1,070)	19,772
Total adjustments	(552)	21,912
Net cash and cash equivalents provided by (used in) operating activities	(7,583)	23,342
Investing activities		
Purchases of investments	(76,940)	(2,999)
Proceeds from sales and maturities of investments	1,995	6,250
Purchases of leasehold improvements and equipment	(2,617)	(791)
Net cash and cash equivalents provided by (used in) investing activities	(77,562)	2,460
Financing activities		
Proceeds from issuance of common stock	1,495	916
Net cash and cash equivalents provided by financing activities	1,495	916
Effect of exchange rate changes on cash and cash equivalents	9	20
Net increase (decrease) in cash and cash equivalents	(83,641)	26,738
Cash and cash equivalents at beginning of period	109,520	17,592
Cash and cash equivalents at end of period	\$ 25,879	\$ 44,330

See accompanying notes.

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INTEVAC, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation***Basis of Presentation***

In the opinion of management, the unaudited interim condensed consolidated financial statements of Intevac, Inc. and its subsidiaries (Intevac or the Company) included herein have been prepared on a basis consistent with the December 31, 2010 audited consolidated financial statements and include all material adjustments, consisting of normal recurring adjustments, necessary to fairly present the information set forth therein. These unaudited interim condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in Intevac's Annual Report on Form 10-K for the fiscal year ended December 31, 2010 (2010 Form 10-K). Intevac's results of operations for the three months ended April 2, 2011 are not necessarily indicative of future operating results.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make judgments, estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ materially from those estimates.

2. New Accounting Pronouncement

In January 2009, the Securities and Exchange Commission (SEC) issued Release No. 33-9002, Interactive Data to Improve Financial Reporting. The final rule requires companies to provide their financial statements and financial statement schedules to the SEC and on their corporate websites in interactive data format using the extensible Business Reporting Language (XBRL). The rule was adopted by the SEC to improve the ability of financial statement users to access and analyze financial data. The SEC adopted a phase-in schedule indicating when registrants must furnish interactive data. Under this schedule, Intevac will be required to submit filings with financial statement information using XBRL commencing with its July 2, 2011 quarterly report on Form 10-Q. Intevac is currently evaluating the impact of XBRL reporting on its financial reporting process.

3. Inventories

Inventories are stated at the lower of average cost or market and consist of the following:

	April 2, 2011	December 31, 2010
	(In thousands)	
Raw materials	\$ 10,500	\$ 13,370
Work-in-progress	9,668	5,295
Finished goods	1,596	2,006
	\$ 21,764	\$ 20,671

Finished goods inventory consists primarily of completed systems at customer sites that are undergoing installation and acceptance testing.

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INTEVAC, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

4. Equity-Based Compensation

At April 2, 2011, Intevac had equity-based awards outstanding under the 2004 Equity Incentive Plan (the 2004 Plan) and the 2003 Employee Stock Purchase Plan (the ESPP). Intevac s stockholders approved both of these plans.

The 2004 Plan permits the grant of incentive or non-statutory stock options, restricted stock, stock appreciation rights, performance units and performance shares. During the three months ended April 2, 2011, Intevac granted 26,000 stock options with an estimated total grant-date fair value of \$185,000. Of this amount, estimated awards of \$46,000 are not expected to vest. During the three months ended April 3, 2010, Intevac granted 87,500 stock options with an estimated total grant-date fair value of \$765,000. Of this amount, estimated awards of \$195,000 are not expected to vest.

The ESPP provides that eligible employees may purchase Intevac s common stock through payroll deductions at a price equal to 85% of the lower of the fair market value at the beginning of the applicable offering period or at the end of each applicable purchase interval. Offering periods are generally two years in length, and consist of a series of six-month purchase intervals. Eligible employees may join the ESPP at the beginning of any six-month purchase interval. During the three months ended April 2, 2011, Intevac granted purchase rights with an estimated total grant-date fair value of \$1.3 million. During the three months ended April 3, 2010, Intevac granted purchase rights with an estimated total grant-date fair value of \$48,000.

Compensation Expense

The effect of recording equity-based compensation for the three-month periods ended April 2, 2011 and April 3, 2010 was as follows:

	Three Months Ended	
	April	
	2,	April 3,
	2011	2010
	(In thousands)	
Equity-based compensation by type of award:		
Stock options	\$ 731	\$ 487
Employee stock purchase plan	231	130
Total equity-based compensation	962	617
Tax effect on equity-based compensation	(269)	(193)
Net effect on net income (loss)	\$ 693	\$ 424

Valuation Assumptions

The fair value of share-based payment awards is estimated at the grant date using the Black-Scholes option valuation model. The determination of fair value of share-based payment awards on the date of grant using an option-pricing model is affected by our stock price as well as assumptions regarding a number of highly complex and subjective variables. These variables include, but are not limited to, our expected stock price volatility over the term of the awards, and actual employee stock option exercise behavior.

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INTEVAC, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

The weighted-average estimated value of employee stock options granted during the three months ended April 2, 2011 and April 3, 2010 was \$7.11 per share and \$8.75 per share, respectively. The weighted-average estimated fair value of employee stock purchase rights granted pursuant to the ESPP during the three months ended April 2, 2011 and April 3, 2010 was \$5.18 per share and \$4.78 per share, respectively. The fair value of each option and employee stock purchase right grant is estimated on the date of grant using the Black-Scholes option valuation model with the following weighted-average assumptions:

	Three Months Ended	
	April	April
	2,	3,
	2011	2010
Stock Options:		
Expected volatility	64.89%	68.34%
Risk free interest rate	2.00%	2.42%
Expected term of options (in years)	4.6	4.5
Dividend yield	None	None
Stock Purchase Rights:		
Expected volatility	52.40%	55.48%
Risk free interest rate	0.51%	0.44%
Expected term of purchase rights (in years)	1.23	0.75
Dividend yield	None	None

The computation of the expected volatility assumptions used in the Black-Scholes calculations for new grants and purchase rights is based on the historical volatility of Intevac's stock price, measured over a period equal to the expected term of the grant or purchase right. The risk-free interest rate is based on the yield available on U.S. Treasury Strips with an equivalent remaining term. The expected term of employee stock options represents the weighted-average period that the stock options are expected to remain outstanding and was determined based on historical experience of similar awards, giving consideration to the contractual terms of the equity-based awards and vesting schedules. The expected term of purchase rights represents the period of time remaining in the current offering period. The dividend yield assumption is based on Intevac's history of not paying dividends and the assumption of not paying dividends in the future.

As the equity-based compensation expense recognized in the Condensed Consolidated Statements of Operations is based on awards ultimately expected to vest, such amount has been reduced for estimated forfeitures. Forfeitures were estimated based on Intevac's historical experience, which Intevac believes to be indicative of Intevac's future experience.

5. Business Combination, Goodwill and Purchased Intangible Assets, Net

On November 19, 2010, Intevac acquired the outstanding shares of Solar Implant Technologies, Inc. (SIT), a privately-owned, development stage company, creating an ion implant module to be used in the manufacturing of photovoltaic cells. Intevac's primary reasons for this acquisition were to complement its existing product offerings and to provide opportunities for future growth. The preliminary aggregate purchase price was \$12.4 million, which consisted of an initial cash payment totaling \$2.7 million and a contingent consideration obligation with a fair value of \$9.7 million payable in cash. In connection with the acquisition, Intevac acquired \$4.0 million of IPR&D, \$43,000 of tangible assets, and \$10.5 million of goodwill and assumed \$703,000 of tangible liabilities. Intevac also recorded an \$827,000 net deferred tax liability to reflect the tax impact of the identified intangible assets that will not generate tax deductible amortization expense net of the future tax benefit of acquired net operating loss carryforwards. The value attributable to IPR&D has been capitalized as an indefinite-lived intangible asset. Goodwill is attributable to estimated synergies arising from the acquisition and other intangible assets that do not qualify for separate recognition. Goodwill

is not deductible for tax purposes.

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INTEVAC, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

In connection with the acquisition of SIT, Intevac agreed to pay up to an aggregate of \$7.0 million in cash to the selling shareholders if certain milestones are achieved over a specified period. Intevac estimated the fair value of this contingent consideration to be in the amount of \$5.6 million based on the probability that certain milestones would be met and the payments would be made on the targeted dates outlined in the acquisition agreement.

In connection with the acquisition of SIT, Intevac also agreed to pay a revenue earnout on Intevac's net revenue from commercial sales of certain products over a specified period up to an aggregate of \$9.0 million in cash to the selling shareholders. Intevac estimated the fair value of this contingent consideration to be in the amount of \$4.1 million based on probability-based forecasted revenues reflecting Intevac's own assumptions concerning future revenue of SIT. A change in the estimated probabilities of revenue achievement could have a material effect on the statement of operations and balance sheets in the period of change.

Any change in fair value of the contingent consideration subsequent to the acquisition date is recognized in operating income within the statement of operations. The fair value of the contingent consideration increased \$300,000 during the three months ended April 2, 2011.

Prior to the acquisition, Intevac had an equity interest in SIT with a cost basis of \$94,000 that was accounted for under the cost method. As a result of revaluing Intevac's equity interest in SIT on the acquisition date, the Company recognized a gain of \$481,000, which was included in other income, net, in the consolidated statement of operations during the fourth quarter of fiscal 2010.

Intevac accounted for the acquisition of SIT as a business combination. Under business combination accounting, the assets and liabilities of SIT were recorded as of the acquisition date, at their respective fair values, and consolidated with the Company. The preliminary purchase price allocation is based on estimates of the fair value of assets acquired and liabilities assumed. Subsequent to the acquisition in the fourth quarter of fiscal 2010, Intevac paid in full \$177,000 in notes payable to certain selling shareholders assumed upon the acquisition. The purchase price was allocated as follows:

(In thousands)

Current assets (including cash of \$38)	\$ 40
Property, plant, and equipment	3
IPR&D	4,000
Goodwill	10,484
Long-term deferred tax assets	697
Total assets acquired	15,224
Notes payable to sellers	177
Current liabilities	526
Long-term deferred tax liabilities	1,524
Total liabilities assumed	2,227
Net assets acquired	\$ 12,997

The results of operations for SIT for periods prior to the acquisition were not material to Intevac's consolidated statements of operations and, accordingly, pro forma financial information has not been presented.

Goodwill and indefinite-life intangible assets are tested for impairment on an annual basis or more frequently upon the occurrence of circumstances that indicate that goodwill and indefinite-life intangible assets may be impaired. In the fourth quarter of fiscal 2010, Intevac performed its annual impairment analysis and the results of the

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INTEVAC, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

analysis indicated that Intevac's goodwill and purchased intangible assets with an indefinite useful life were not impaired. At April 2, 2011, Intevac had a total of \$18.4 million of goodwill and \$4.1 million of indefinite-life intangible assets. At April 2, 2011, \$10.5 million of goodwill is attributed to the Equipment segment and \$7.9 million of goodwill is attributed to the Intevac Photonics segment.

Total amortization expense of finite-lived intangibles for the three months ended April 2, 2011 was \$136,000. As of April 2, 2011, future amortization expense is expected to be \$406,000 for the remainder of 2011, \$541,000 for 2012, \$541,000 for 2013, \$363,000 for 2014, \$284,000 for 2015 and \$593,000 thereafter. Intangible assets by segment are as follows: Equipment: \$5.9 million and Intevac Photonics: \$945,000.

6. Warranty

Intevac provides for the estimated cost of warranty when revenue is recognized. Intevac's warranty is per contract terms, and for systems sold directly the warranty typically ranges between 12 and 24 months from customer acceptance. For systems sold through a distributor, Intevac offers a 3 month warranty. The remainder of any warranty period is the responsibility of the distributor. During this warranty period any defective non-consumable parts are replaced and installed at no charge to the customer. The warranty period on consumable parts is limited to their reasonable usable lives. Intevac uses estimated repair or replacement costs along with its historical warranty experience to determine its warranty obligation. Intevac generally provides a twelve month warranty on its Intevac Photonics products. The provision for the estimated future costs of warranty is based upon historical cost and product performance experience. Intevac exercises judgment in determining the underlying estimates.

On the Condensed Consolidated Balance Sheets, the short-term portion of the warranty provision is included in other accrued liabilities, while the long-term portion is included in other long-term liabilities. The expense associated with product warranties issued or adjusted is included in cost of net revenues on the Condensed Consolidated Statements of Operations.

The following table displays the activity in the warranty provision account for the three-month periods ended April 2, 2011 and April 3, 2010:

	Three months ended	
	April	
	2,	April 3,
	2011	2010
	(In thousands)	
Beginning balance	\$ 3,415	\$ 1,602
Expenditures incurred under warranties	(817)	(591)
Accruals for product warranties issued during the reporting period	380	764
Adjustments to previously existing warranty accruals	114	79
Ending balance	\$ 3,092	\$ 1,854

The following table displays the balance sheet classification of the warranty provision account at April 2, 2011 and at December 31, 2010:

	April	December
	2,	31,
	2011	2010
	(In thousands)	
Other accrued liabilities	\$ 2,371	\$ 2,612
Other long-term liabilities	721	803

Total warranty provision	\$ 3,092	\$	3,415
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INTEVAC, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

7. Guarantees***Officer and Director Indemnifications***

As permitted or required under Delaware law and to the maximum extent allowable under that law, Intevac has certain obligations to indemnify its current and former officers and directors for certain events or occurrences while the officer or director is, or was serving, at Intevac's request in such capacity. These indemnification obligations are valid as long as the director or officer acted in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the corporation and, with respect to any criminal action or proceeding, had no reasonable cause to believe his or her conduct was unlawful. The maximum potential amount of future payments Intevac could be required to make under these indemnification obligations is unlimited; however, Intevac has a director and officer insurance policy that mitigates Intevac's exposure and enables Intevac to recover a portion of any future amounts paid. As a result of Intevac's insurance policy coverage, Intevac believes the estimated fair value of these indemnification obligations is not material.

Other Indemnifications

As is customary in Intevac's industry, many of Intevac's contracts provide remedies to certain third parties such as defense, settlement, or payment of judgments for intellectual property claims related to the use of its products. Such indemnification obligations may not be subject to maximum loss clauses. Historically, payments made related to these indemnifications have been immaterial.

8. Cash, Cash Equivalents and Investments

Cash and cash equivalents, short-term investments and long-term investments consist of:

		April 2, 2011		
	Amortized Cost	Unrealized Holding Gains	Unrealized Holding Losses	Fair Value
		(In thousands)		
Cash and cash equivalents:				
Cash	\$ 19,091	\$	\$	\$ 19,091
Commercial paper	3,000			3,000
Money market funds	3,788			3,788
Total cash and cash equivalents	\$ 25,879	\$	\$	\$ 25,879
Short-term investments:				
Commercial paper	\$ 19,237	\$ 4	\$	\$ 19,241
Corporate bonds and medium-term notes	9,892	10	2	9,900
Municipal bonds	2,232		1	2,231
U.S. treasury and agency securities	7,513	3		7,516
Variable rate demand notes (VRDNs)	11,375			11,375
Total short-term investments	\$ 50,249	\$ 17	\$ 3	\$ 50,263
Long-term investments:				
Corporate bonds and medium-term notes	\$ 24,653	\$ 1	\$ 42	\$ 24,612
Municipal bonds	3,432	4		3,436
U.S. treasury and agency securities	13,977		12	13,965
Auction rate securities (ARS)	10,900		619	10,281
Total long-term investments	\$ 52,962	\$ 5	\$ 673	\$ 52,294

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Total cash, cash equivalents, and investments	\$ 129,090	\$ 22	\$ 676	\$ 128,436
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INTEVAC, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

	Amortized Cost	December 31, 2010		
		Unrealized Holding Gains	Unrealized Holding Losses	Fair Value
		(In thousands)		
Cash and cash equivalents:				
Cash	\$ 22,887	\$	\$	\$ 22,887
Commercial paper	2,999		1	2,998
Corporate bonds	1,259			1,259
Money market funds	82,376			82,376
Total cash and cash equivalents	\$ 109,521	\$	\$ 1	\$ 109,520
Short-term investments:				
Commercial paper	\$ 2,995	\$	\$	\$ 2,995
U.S. treasury and agency securities	1,999			